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Beneficial Owner: Judicial Variety in Interpretation Counteracted by the 2012 OECD Proposals?*

Jan Gooijer**

The 2012 OECD proposals on beneficial ownership aim to remove the existing ambiguity and differences in interpretation of this concept. This contribution contains an assessment of the proposals taking into account the historical development of the concept and case law from various countries. Some further amendments are proposed that will help to achieve a uniform interpretation.

I INTRODUCTION AND BACKGROUND

The meaning of the term 'beneficial owner' as referred to in Articles 10, 11, and 12 of the OECD Model Tax Convention ('OECD MC') has long been subject to discussion.¹ As the OECD explained, the publication of the discussion draft entitled *Clarification of the meaning of 'beneficial owner' in the OECD Model Tax Convention* on 29 April 2011 was prompted by the varying ways in which national courts and other parties have interpreted the term.² Following the comments received in response to this draft, a revised version (*Revised Proposals concerning the Meaning of Beneficial Owner in Articles 10, 11, and 12 of the OECD Model Tax Convention*)³ was published on 19 October 2012. As well as the relevance that the OECD's initiative has for international tax law from a theoretical perspective, the recent discussions in both the political world and the media on issues such as the use of conduit companies make it abundantly clear that this topic is also of great importance to broader society.

This contribution focuses on whether the changes proposed by the OECD will remove the ambiguity and put an end to the resultant differing interpretations by national courts, such that courts will in future be able to assume a uniform meaning. If it is concluded that this is not the case, or that it applies to only a limited degree, it needs to be established what still has to be done in order to ensure a uniform interpretation.⁴

2 STRUCTURE OF THIS CONTRIBUTION

The first step in answering the questions at the centre of this contribution is to establish how national courts are currently interpreting the term.⁵ The examination of case law, which is discussed in section 5, drew on the IBFD's tax treaty case law database. A degree of caution needs, however, to be exercised in respect of the judgments used as the basis for assessing how terms in the OECD MC are interpreted by national courts. First, these judgments

Notes

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¹ The term 'beneficial owner' has been widely discussed in literature, very recently in D.G. Duff et al. *Beneficial Ownership: Recent Trends* (M. Lang et al. eds., IBFD 2013), Online Books IBFD (accessed 19 Sep. 2013). Furthermore I refer to the following publications: S. van Weeghel, *The improper use of tax treaties*, Deventer: Kluwer 1998, p. 64ff; C. Du Toit, *Beneficial Ownership of Royalties in Bilateral Tax Treaties*, Amsterdam: IBFD, 1999; J. Oliver, J. Libin, S. van Weeghel and C. Du Toit, *Beneficial Ownership and the OECD Model*, British Tax Review 2001, p. 27ff; J. Wheeler, *The Attribution of Income to a Person for Tax Treaty Purposes*, Bulletin for International Taxation 2005, No. 11, pp. 477–488; L. De Broe, *International Tax Planning and Prevention of Abuse*, Amsterdam: IBFD, 2008, p. 654ff, and C. Du Toit, *The Evolution of the Term 'Beneficial Ownership' in Relation to International Taxation over the Past 45 Years*, Bulletin for International Taxation 2010, No. 10, pp. 500–539.

² After assessing case law on the issues relating to the term beneficial owner, Jinyan Li 'makes the case for more clarity through changes to the Commentary on the ground that international case law is confusing, causing uncertainty for taxpayers, and that revising the Commentary is the most practical solution'. Li, Jinyan, *Beneficial Ownership in Tax Treaties: Judicial Interpretation and the Case for Clarity* (7 Feb. 2012). Osgoode CLPE Research Paper No. 4/2012, p. 206, available at SSRN: <http://ssrn.com/abstract=2000816> or <http://dx.doi.org/10.2139/ssrn.2000816>.

³ The initial proposal, the reactions to this and the amended proposal can be found on <http://www.oecd.org/tax/treaties/oecdmodeltaxconventionreviseddiscussiondraftonthemeaningofbeneficialowner.htm>. For an examination of the discussion draft, together with the reactions published on the OECD website, see also R.J. Danon, *Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention – Comment on the April 2011 Discussion Draft*, Bulletin for International Taxation 2011, No. 8, pp. 437–442, and W.R. Munting, *Beneficial Ownership: handle with care*, WFR 2012/1064.

⁴ For a discussion of the revised proposals of 19 Oct. 2012, see also VN 2012/62.4 and W.R. Munting & R. Huisman, *'Beneficial Ownership: handle with care'. Update naar aanleiding van het gewijzigde OESO-voorstel*, WFR 2013/219.

⁵ For an overview of tax authorities' policy on the term 'beneficial owner', see R. Collier, *Clarity, opacity and beneficial ownership*, British Tax Review 2011, No. 6, p. 693.

relate to the interpretation of a specific treaty in a specific case, and the interpretation's significance for the OECD MC may therefore be limited. Second, not all these judgments have been substantiated equally, logically, and consistently, and so their meaning is not always entirely clear.⁶ Third, language barriers meant it was not always possible to examine all the judgments in the language in which they were originally given, and recourse sometimes had to be sought to English summaries.⁷ The summaries of judgments in the IBFD database and the subsequent discussions in international tax law literature are assumed to form a sufficient substantive basis for the research.

In order to ensure a proper reading of the case law discussed in section 5 it is important to understand how the term 'beneficial owner' has developed over time. This will also help in understanding the changes proposed by the OECD. Section 4 consequently serves as an introduction to section 5 by outlining the history of the term since it was first introduced in 1977. Section 6 goes on to discuss and comment on the proposed OECD Commentary, with the proposals included in full insofar as relevant to this contribution. Answers to the questions at the centre of this contribution are provided in section 7. First, however, the terms 'income conduit' and 'entity conduit' are explained in section 3 in order to ensure that the way they are used in the rest of the contribution is correctly understood.

3 'INCOME CONDUIT' AND 'ENTITY CONDUIT'

As in Wheeler,⁸ this contribution makes a distinction between an 'income conduit' and an 'entity conduit'. This distinction is important for a proper understanding of the case law examined, while various OECD reports also refer to both types of conduits, particularly the entity conduit. These types of conduits are described below.

Both conduits receive income in the form of dividends, interest, or royalties. An income conduit has a certain obligation to pass on income it receives and will normally be subject to a low effective rate of tax because the income passed on will be able to be deducted as an expense from the income received. Assuming an income conduit can be

considered the beneficial owner of the income received, it can claim eligibility for the reduced rate of withholding tax available under the tax treaty between the state in which the income conduit has its seat and the source state.

An entity conduit, however, has no obligation to pass on income received. The effective rate of tax on such a conduit – an intermediate holding company, for example, – will be low, either thanks to its being eligible for a form of participation exemption or to the low rate of tax applying. Like an income conduit, an entity conduit can also claim eligibility for the benefits under the tax treaty between the residence and source states, but obviously only if it can be designated the beneficial owner.

4 HISTORICAL DEVELOPMENT⁹

4.1 Introduction of 'Beneficial Owner' in the OECD MC 1977

The term 'beneficial owner' was introduced into the OECD MC in 1977 at the initiative of the United Kingdom ('UK').¹⁰ In 1967, the OECD had asked the Member States to list the aspects in the 1963 draft OECD MC that were causing problems for them. The UK delegation favoured amending Articles 10, 11, and 12 in order to prevent abuse.¹¹ The delegation stated that the relief provided for under these articles should apply only if the beneficial owner of the specific income was resident in the other contracting state. It was, therefore, proposed adding either of the following two conditions: (1) the income received must be subject-to-tax or, (2) the income must be beneficially owned by the recipient.

The delegation referred to protocols in the UK's 1966 treaties with the United States ('US') and Switzerland, in which eligibility for relief required the amounts paid to be 'beneficially owned by a resident'. According to the delegation, this clarified what had originally been intended.¹² The new protocols in these treaties marked a departure from the original requirement of being subject to tax.¹³ Under subsection 4 of the dividend article in these treaties, this requirement continued to apply only in situations in which the shares on which the dividend was

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⁶ See also David A. Ward, 'Use of foreign court decisions in interpreting tax treaties', in J. Wouters et al. *Courts and Tax Treaty Law* (G. Maisto ed., IBFD 2007), para. 7.1.

⁷ C. Du Toit, *supra*, p. 501.

⁸ J. Wheeler, *supra*, p. 478.

⁹ The historical documents referred to are available via <www.taxtreatieshistory.org>. For a very detailed examination of the history of the concept see R. Vann, *Beneficial Ownership: What Does History (and Maybe Policy) Tell Us*, in Duff et al. *supra*, Ch. 19.

¹⁰ For a discussion of the background to the term 'beneficial owner', see J.F. Avery Jones, *The United Kingdom's Influence on the OECD Model Tax Convention*, *British Tax Review* 2011, No. 6, p. 677.

¹¹ '(...) otherwise the Articles are open to abuse by taxpayers who are resident in third countries and who could, for instance, put their income into the hands of bare nominees who are resident in the other contracting State.' TFD/FC/216.

¹² '(...) clearly reflects what was intended by the Committee when the Model Convention was prepared.' TFD/FC/216 and TFD/FC/218.

¹³ The protocol states that '(...) relief from tax on dividends, interests and royalties . . . in the country of origin will no longer depend on whether the recipient is subject to tax in the other country, but will depend on the income being beneficially owned by a resident of the other country'. Du Toit [*supra*, p. 1] states that the term 'beneficial owner' as used in the treaty between the UK and US has to be interpreted in accordance with national law, given that the term derives from the common law tradition.

distributed were not obtained 'for bona fide commercial reasons and not primarily for the purpose of securing the benefit of this Article' and providing a number of other conditions were satisfied. The 1966 treaty between the UK and Canada also included comparable provisions, both in respect of the conditions for entitlement to withholding tax relief on income ('beneficially owned by a resident') and in respect of the anti-abuse provision in the dividend article. The interest article, however, contained a different anti-abuse provision.¹⁴ Subsection 5 of the article imposed a subject-to-tax requirement if the beneficial owner sold the underlying asset within three months of the date on which it was acquired.

Working Party 27 ('WP 27')¹⁵ was instructed by the OECD Fiscal Committee to examine the UK's proposal in more detail. WP 27 adopted a conservative stance by concluding that a subject-to-tax approach was not considered consistent with the spirit or structure of the OECD MC,¹⁶ while the requirement for the recipient to be 'actually resident' was seen as evident from the wording of paragraph 1.¹⁷ It was not felt necessary to introduce the concept of the beneficial owner, and the discussion consequently reverted to the Fiscal Committee.¹⁸

Between 1967 and 1969, the UK agreed new treaties with various other countries (mainly OECD members)¹⁹ and protocols for addition to existing treaties.²⁰ The articles on dividends, interest, and royalties in these treaties and protocols were not revised in line with the OECD's 1963 draft-MC.²¹ Apart from a few details,

therefore, most of these provisions are the same as in the articles referred to above in the UK's treaties with Switzerland, the US, and Canada. It is only in the treaties with Luxembourg (1967), Belgium (1967), and France (1968) that the UK included the subject-to-tax requirement instead of the requirement for beneficial ownership. All the treaties also include an anti-abuse provision, the contents of which are largely similar to Article 4 of the treaty with Switzerland, albeit that the subject-to-tax clause in some of the treaties is worded differently²² or has been omitted.²³

The UK delegation's proposals were examined during the discussions of the first WP 27 report, when the delegation once again pushed for inclusion of a subject-to-tax clause or a beneficial ownership condition. The Swiss and US delegations opted in favour of the beneficial ownership condition; this was not illogical, given the protocols they had recently agreed with the UK. The German delegation, however, saw no need to include the beneficial ownership concept in the Model Convention as, in its view, the text was already sufficiently clear. All that was needed, Germany believed, was to amend the Commentary in respect of this point.²⁴ The issue of the anti-abuse provisions included in the various treaties agreed by the UK did not actually come up for discussion.

The consultations resulted in a recommendation by WP 27 to introduce the concept of beneficial ownership. WP 27 felt that a subject-to-tax clause could potentially create problems as far as interpreting the concept of 'subject to

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Avery Jones [*supra*, p. 680] suggests that the US and Switzerland opted for the concept of beneficial ownership rather than subject to tax for reasons relating to tax-exempt entities such as pension funds. Baker refers to documents from the UK national archives to show that the position of tax-exempt bodies was the reason why the UK negotiators regarded the term as an alternative to the subject-to-tax requirement. The first occasion on which the UK proposed using the term 'beneficial owner' was in the treaty negotiations with the Netherlands. See P. Baker, 'The Meaning of "Beneficial Ownership" as Applied to Dividends under the OECD Model Tax Convention', in K. Lenaerts et al. *Taxation of Intercompany Dividends under Tax Treaties and EU Law*, G. Maisto (ed.) IBFD 2012, para. 6.2.

¹⁴ Article 10 (interest) states:

1. The United Kingdom tax on interest (on bonds, securities, debentures, or on any other form of indebtedness) derived and beneficially owned by a resident of Canada shall not exceed 15 per cent of the gross amount of the interest.
2. The Canadian tax on interest (on bonds, securities, debentures, or on any other form of indebtedness) derived and beneficially owned by a resident of the United Kingdom shall not exceed 15 per cent of the gross amount of the interest. (...)
5. The provisions of paragraphs 1 and 2 of this Article shall not apply to interest where the beneficial owner of the interest:
 - (a) Is not subject to tax in respect thereof in the territory of which it is a resident; and (b) Sells (or makes a contract to sell) the holding from which the interest is derived within three months of the date on which such beneficial owner acquired that holding.

See also TFD/FC/214.

¹⁵ The name was later changed to 'Working Group', but for clarity's sake I have used the abbreviation 'WP' throughout this contribution.

¹⁶ 'If it is the desire of the United Kingdom Delegation to make relief in the country of source dependent on effective liability to tax in the recipient's country of residence, then the suggestion would be contrary to the spirit and the general arrangement of the Draft Convention.' FC/WP27(68)1.

¹⁷ 'On the other hand, it is evident that relief in the country of source applies only if the recipient is actually resident in the other contracting State. This is stated clearly in the text of paragraph 1. Moreover, determining who is the true recipient and his State of residence is a matter of administration and inspection.' FC/WP27(68)1.

¹⁸ 'The Committee will be asked to give its opinion on the comment made by the United Kingdom Delegation.' FC/WP27(68)1.

¹⁹ The Netherlands (1967), Luxembourg (1967), Belgium (1967), Portugal (1968), France (1968) and Finland (1969).

²⁰ Denmark (1968) and Sweden (1968).

²¹ DAF/FC/69.8.

²² The treaty with the Netherlands (1967) states, for example, 'does not suffer tax thereon'. Paragraph six of the interest article in the treaty between the Netherlands and the UK includes the following anti-abuse provision: 'The provisions of this Article shall not apply if the debt-claim in respect of which the interest is paid was created or assigned mainly for the purpose of taking advantage of this Article and not for bona fide commercial reasons.' The concept of beneficial ownership would appear not to be considered suitable as a means of combating such structures.

²³ In, for example, the treaty with Finland (1969).

²⁴ DAF/FC/69.10, para. 25.

effective taxation' was concerned and also regarded such a clause as contravening 'the spirit and general economy of the Draft Convention', and it did not envisage the existing text causing any significant problems for a 'genuine' agent.²⁵ According to the WP, the term 'beneficial owner' was important only in order to avoid granting treaty benefits to a person receiving income, whether in its own name or otherwise, for the account and risk of another party. The Fiscal Committee consequently decided to amend the text of and the Commentary on Article 11 as follows:

Article 11 – Interest

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State *if such resident is the beneficial owner of the interest* (*underlining: JG*).
(...)

Commentary on Article 11

18. (...) The purpose of the condition added at the end of paragraph 1 of the Article [*beneficial ownership, JG*] is to ensure that the relevant residential qualification shall be residence in the other State by the person beneficially entitled to the interest and not residence there by any intermediary such as an agent or nominee, interposed between the payer and the beneficiary having the legal right to receive the income. The term 'paid' is capable of very wide construction, since the concept of 'payment' means 'the fulfilment of the obligation to put funds under the control of the creditor in the manner required by contract or by custom.'^{26/27}

Article 12 and the Commentary on it were also amended accordingly.

4.2 Abuse of Tax Treaties (I): Working Party 21

Another working party ('WP 21'), which was established alongside WP 27, was instructed to compile an inventory of cases involving the abuse of tax treaties and to make recommendations for measures to combat such actual or alleged abuse. One aspect attracting particular attention in this context was the use of legal entities in third states specifically for the purpose of obtaining access to treaty

benefits.²⁸ WP 21's main focus was on the use of entity conduits.

Although a detailed examination of the work of WP 21 would go beyond the scope of this contribution, it is important in my view to consider its ultimate conclusions.²⁹ WP 21 suggested that the extent to which tax relief was available on dividends in a situation in which a company in a third state was interposed in order to obtain access to the benefits under a tax treaty between that third state and the source state should depend on the extent of taxation at the intermediate holding company level. In other words, a subject-to-tax requirement should apply.³⁰ The same solution was also proposed for interest.³¹ However these conclusions did not result in an anti-abuse provision being included in the OECD MC. The work of WP 21 resulted in paragraphs 7–10 being included in the Commentary on Article 1 OECD MC 1977, whereby the important provisions as far as this contribution is concerned are as follows:

8. Moreover, the extension of the network of double taxation conventions still reinforces the impact of such manoeuvres as they make it possible, through the creation of usually artificial legal constructions, to benefit both from the tax advantages available under certain domestic laws with the reliefs from tax provided for in double taxation conventions.

9. This would be the case, for example, when a person (whether or not a resident of a Contracting State), would act through a legal entity created in a State essentially to obtain treaty benefits which would not be available directly to such person. (...)

10. Some of these situations are dealt with in the Convention, e.g. by the introduction of the concept of 'beneficial owner' (in Articles 10, 11 and 12) (...). Such problems are also mentioned in the Commentaries on Article 10 (paragraphs 17 and 22), Article 11 (paragraph 12), [and] Article 12 (paragraph 7). It may be appropriate for Contracting States to agree in bilateral negotiations that any relief from tax should not apply in certain cases, or to agree that the application of the provisions of domestic laws against tax avoidance shall not be affected by the Convention.³²

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²⁵ 'There is no reason to think that the case of the person acting manifestly as an agent in the name and on behalf of the beneficial owner gives rise to any difficulties.' FC/WP27(70)1.

²⁶ FC(71)1.

²⁷ In the case of the dividend article, Working Party 23 agreed with the findings and recommendations of Working Party 27. CFA/WP1(73)2.

²⁸ FC/WP21 (67)1.

²⁹ See for such detailed examination Vann, *supra*, para. 19.4.2.

³⁰ CFA/WP1(75)3.

³¹ CFA/WP1(75)3, p. 23. In a previous report WP 21 had incidentally made two other, much more radical suggestions. Although these suggestions were not discussed in any further detail for reasons of a largely administrative nature, they indicate that the concept of beneficial owner was in any event not considered sufficient. According to the WP, the treaty could state (a) that a base company did not constitute a company for the purposes of applying the treaty, and that this would mean that distributions by such a company would not qualify for a reduced rate of withholding tax, or (b) that a base company could constitute a permanent establishment of its shareholder's enterprise. FC/WP21(67)1, p. 39.

³² DAF/CFA/WP1/76.19, p. 146.

The references to paragraphs 17 and 22 of the Commentaries on Article 10 refer to situations in which transactions are entered into in order to obtain treaty benefits or where entity conduits are used for this purpose.³³

4.3 Assessment of OECD MC 1977

It can be concluded from the considerations and solutions proposed in the various WP 27 and WP 21 reports³⁴ and the text of the Commentaries on Articles 1, 10, 11, and 12 OECD MC 1977 that the concept of beneficial owner is considered an anti-abuse provision with limited scope. The requirement for a beneficial owner can be seen as further refining the terms 'paid to' and 'received by', although in certain countries these terms, too, are not interpreted literally.³⁵

The concept was not considered suitable for combating the abuse of tax treaties through the use of entity conduits. Although the use of income conduits was not explicitly discussed, the chosen wording ('any intermediary such as an agent or nominee') means the possibility cannot be excluded that an intermediary not constituting an 'agent or nominee' can nevertheless disqualify as a beneficial owner.³⁶ The question remains, however, as to when such an intermediary will be considered to exist.

4.4 Abuse of Tax Treaties (II): The 'Conduit Report'

The abuse (alleged or otherwise) of tax treaties and the role of the beneficial ownership concept in combating such abuse was examined again in the 1986 *Double Taxation Conventions and the Use of Conduit Companies* report (the 'Conduit Report').³⁷ This report considers, both for entity and income conduits, whether the changes in the 1977 OECD MC can be regarded as satisfactory. On the subject of beneficial ownership, the report states the following in paragraph 14(b):

Articles 10 to 12 of the OECD Model deny the limitation of tax in the state of source on dividends,

interest and royalties if the conduit company is not its beneficial owner. Thus the limitation is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income. The commentaries mention the case of a nominee or agent. The provisions would however apply also to other cases where a person enters into contracts or takes over obligations under which he has a similar function to those of a nominee or agent. Thus a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties. This is however different if the beneficial owner is equally resident in the state of the formal recipient. (...) In practice, however, it will usually be difficult for the country of source to show that the conduit company is not the beneficial owner.

The committee ultimately decided that the beneficial owner concept was not suited for resolving the problem of conduit companies,³⁸ given the statement in paragraph 15 that 'The new provisions of the 1977 OECD Model thus deal with the conduit situation in a rudimentary way, expressing only a general concern that improper use of treaties should be avoided.' In my view, this conclusion is wholly consistent with the results of the WP 21 report (see 4.2 above).

4.5 Commentary on the 2003 OECD MC

The Commentary on the 2003 OECD MC examines the beneficial owner concept in more detail. According to the notes on the 2003 amendments, the primary focus is on the income conduit:

While it is obvious that the use of the concept excludes bare legal ownership as the criterion for determining availability of treaty benefits it is less apparent what is intended to be the salient connection with a stream of income in a case where different interests in the income

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³³ Paragraph 17 relates to transactions entered into for the sole purpose of complying with the conditions needed to obtain the reduced rate of tax (the 25% requirement, for example), while para. 22 relates to entity conduits. In both situations states are asked to consider including a specific anti-abuse rule.

³⁴ Unfortunately the report on the discussions of the final WP 21 report was not included in the relevant document (DAF/CFA/WP1/76.1).

³⁵ See the US case *Aiken Industries v. Commissioners*, 56 T.C. 925 (1971), in which the US court – on the basis, interestingly, of a national law definition – stated that 'The words "received by" refer not merely to the obtaining of physical possession on a temporary basis of funds representing interest payments from a corporation of a contracting State, but contemplate complete dominion and control over the funds.'

³⁶ Vann, *supra* [para. 19.4.2.] concludes that the term beneficial ownership throughout the WP21 reports is used in two different senses being on the one hand a reference to the ultimate economic owner and on the other hand the use of nominees and holding companies to obtain treaty benefits. See, amongst others, Collier, *supra*, p. 690, Duff, *supra*, fn. 120 ('... the concept of beneficial owner is sufficiently open-ended when divorced from its common law foundations (...) to apply to conduit company arrangements') and P. Pistone, 'Italy: Beneficial Ownership as Anti-Abuse Provision in International Taxation', in Duff et al. *supra*, fn. 6, who recognize the anti abuse character of the beneficial owner concept.

³⁷ OECD, 'Double Taxation Conventions and the Use of Conduit Companies', Issues in International Taxation No. 1, in *International Tax Avoidance and Evasion*, Paris 1987.

³⁸ See also Collier, *supra*, p. 688.

are held by diverse hands who might each be considered, as a matter of general law, to possess some attributes of ownership.³⁹

Paragraphs 12 and 12.1 of the Commentary on Article 10 of the OECD MC 2003 state, insofar as relevant, that:

12 (...) The term 'beneficial owner' is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

12.1 (...) It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship simply acts as a conduit for another person who in fact reserves the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled 'Double Taxation Conventions and the Use of Conduit Companies' concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

Views in literature on the impact of these amendments vary substantially. While Baker, for example, regards it as 'relatively easy to understand and (...) quite narrow in its scope as to who are not beneficial owners of the income',⁴⁰ others see the changes as a conscious (but failed) attempt to restructure the concept of beneficial owner into a broad anti-abuse provision.⁴¹ I disagree with this latter conclusion. As I explained earlier, I see the 1977 changes

as having created scope for intermediaries other than 'agents and nominees' not to be considered beneficial owners. This would apply in situations in which an intermediary – subject to all the applicable legal obligations – de facto has the same role as an agent, despite formally being the owner of the funds received.⁴² In my opinion, the 2003 changes therefore represent a further elaboration rather than a new interpretation of the concept of beneficial owner. However, the wording of the added paragraphs resulted in some countries in – as Vann puts it – 'an aggressive, essentially discretionary, use by the tax administration of "beneficial ownership" in recent times to deny treaty benefits'.⁴³

5 CASE LAW

This section examines case law involving the concept of beneficial owner,^{44/45} with a distinction being made between cases before and after publication of the 2003 Commentary on the OECD MC.

5.1 Case Law before 2003

The judgments in four of the cases examined were issued before the OECD Commentary was amended in 2003. The critical issue for both the Dutch Supreme Court (*Hoge Raad*) in the 'market maker' case⁴⁶ and the Spanish Tax Court (*Tribunal Económico Administrativo Central*) and National Court (*Audiencia Nacional*)⁴⁷ was whether the receiving company was the legal owner of the dividends and royalties paid. The Dutch Supreme Court ruled that the company receiving the dividends did not need to be the legal owner of the shares in order to be considered the

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³⁹ OECD, 2002 Reports Related to the OECD Model Tax Convention, No. 8, para. 23.

⁴⁰ Baker, *supra*, para. 6.2.

⁴¹ See, for example, L. Verdoner, R. Offermans and S. Huibregtse, *A Cross-Country Perspective on Beneficial Ownership – Part 1*, European Taxation, September 2010 and E. Robert, *Who Is the True Taxpayer*, European Taxation 2012, No. 2/3, p. 55.

⁴² Collier *supra*, p. 693: 'On this basis, it might be difficult to see quite why the term has been proving to be so very problematic in practice.'

⁴³ Vann, *supra*, para. 19.5.2.

⁴⁴ The scope of the concept is considered in 22 of the cases included in the IBFD database under 'beneficial owner'. Most of the cases examined dated from after the amendment of the OECD Commentary in 2003, with only four cases dating back earlier. Although these older cases were included in the examination, the dictum may be considered less important, given that the judgments did not take account of recent developments. A number of the judgments were also discussed in A.M. Jiménez, *Beneficial Ownership: Current Trends*, World Tax Journal 2010, No. 2, pp. 35–63; F.P.G. Pötgens, 'Uiteindelijk gerechtigde onder Nederlandse belastingverdragen: nationaal recht of context', in K. Braun et al. (eds), *40 Jaar Cursus Belastingrecht. Opstellen aangeboden aan Leno Sillevius en Nico de Vries, ter gelegenheid van hun afscheid als hoofdredacteur respectievelijk lid van de hoofdredactie bij het 40-jarig bestaan van de Cursus Belastingrecht*, Deventer: Kluwer 2010, pp. 167–176, and L. Verdoner, R. Offermans and S. Huibregtse, *A Cross-Country Perspective on Beneficial Ownership – Part 1*, European Taxation 2010, No. 9 and *A Cross-Country Perspective on Beneficial Ownership – Part 2*, European Taxation 2010, No. 10 and in Duff et al. *supra*, Chs 2 (UK), 3 (Canada), 4 (Switzerland), 5 (Netherlands), 6 (Denmark), 8 and 12 (Spain), 10 and 11 (France).

⁴⁵ Banfi and Manegazza discuss two judgments by a lower Italian court that are not included in the IBFD database: *Commissione Tributaria Provinciale* of 11 Feb. 2010 (No. 14) and 19 Oct. 2010 (No. 124). Both cases relate to an income conduit receiving royalties. In both cases the court referred to the anti-abuse nature of the term (based on the 2003 OECD Commentary) and assessed the situation on the basis of an analysis of the actual activities of the company receiving the royalties and the decision-making processes. In this way the term 'beneficial owner' was given an economic interpretation, while no attention seemed to be paid to the issue of ownership ('very narrow powers'). L. Banfi and F. Mantegazza, *An Update on the Concept of Beneficial Ownership from an Italian Perspective*, European Taxation 2012, No. 2/3, pp. 57–66. See for Italian case law also Pistone, *supra*, Ch. 12.

⁴⁶ *Hoge Raad*, 6 Apr. 1994, BNB 1994/214.

⁴⁷ *Tribunal Económico Administrativo Central*, 22 Sep. 2000, RG 6294/1996. The issue here concerned the application of Art. 12 of the tax treaty between Spain and the US to royalty payments made to companies managing copyrights for and on behalf of authors. The court ruled that the companies had to be regarded as intermediaries acting on behalf of the authors and so could not be seen as the beneficial owners of the royalties received. The judgment of the *Tribunal Económico Administrativo Central* was confirmed by the *Audiencia Nacional* on 19 Jun. 2003. See also Jiménez, *supra*, p. 36.

beneficial owner of the dividends. Instead, it was sufficient for that party, after purchasing the coupons, to have discretion to use the specific coupons and the dividends received.⁴⁸

The German Fiscal Court (*Finanzhof*) in Cologne⁴⁹ and the French Supreme Administrative Court (*Conseil d'Etat*)⁵⁰ took non-juridical circumstances into account in the cases examined. Both cases concerned an income conduit. The critical issue in the view of the German court was that the company to which the royalties received by the conduit were passed had a decisive vote on the licensing agreements signed by the conduit, while the court in the French *Diebold Courtage* case ruled that the extent and nature of the services provided by the affiliated company (which in this case received 68% of the royalties) justified the onward payment. The fact that the payment was passed on did not cause the French court to conclude that the income conduit was not a beneficial owner.⁵¹

5.2 Case Law Since 2003

United Kingdom

The ruling by the English Court of Appeal in the *Indofood* case⁵² was the first judgment to make explicit reference to the 2003 OECD Commentary. This was a civil case in which the court was asked to rule on the opportunity to reduce the withholding tax on interest paid by a resident of Indonesia to a private limited company ('Newco') resident in the Netherlands. Under the structure, Newco was to pass on all the interest it received to the holders of loan notes issued and would receive a separate fee for the

costs and risks incurred.⁵³ The court referred to the Conduit Report, the 2003 OECD Commentary and Baker's commentary in concluding that the term 'beneficial owner' had a tax treaty meaning autonomous of national law. In order to be regarded as the beneficial owner of income, the company needed to have 'the full privilege to directly benefit from the income'. The Court of Appeal concluded that this requirement was not satisfied in this case as Newco was obliged to pass on all funds received to the bondholders and was contractually precluded from finding or using money from other sources.⁵⁴ The court emphasized that what happened in practice also led to the same conclusion. In other words, that it was impossible to conceive of any circumstances in which Newco would derive any direct benefit from the interest payable, except by funding its liability to the bondholders. 'Such an exception can hardly be described as the "full privilege" needed to qualify as the beneficial owner, rather the position of the Issuer and Newco equates to that of an "administrator of the income".'⁵⁵

Indonesia

The Indonesian court reached the same conclusion in PUT-23288⁵⁶ (which involved the same pattern of facts as in *Indofood*) and, in doing so, also referred to tax literature and the 2003 OECD Commentary. The fact that a substance-over-form approach should be applied had previously been established by the Indonesian court.⁵⁷ There, too, the court referred to the OECD Commentary and stated that the term 'beneficial owner' had an autonomous tax treaty meaning not derived from the domestic laws of the contracting states.

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⁴⁸ Van Weeghel stated that the Supreme Court disregarded the question of whether this freedom should be assessed procedurally or substantively. The examples given by the Supreme Court point, he believes, towards a procedural, juristic interpretation. See S. van Weeghel in his role as expert witness in *Prévost Car Inc.* (2008 TCC 231), 22 Apr. 2008 (<http://decision.tcc-cci.gc.ca/en/2008/2008tcc231/2008tcc231.html>). D.S. Smit is of the same opinion. D.S. Smit, 'The Concept of Beneficial Ownership and Possible Alternative Remedies in the Netherlands Case Law', in Duff et al. *supra*, para. 5.2.4.1.

⁴⁹ *Finanzhof Köln*, 24 Oct. 1996, 2 K 3358/93. X BV (a resident of the Netherlands) passed 95%–98% of the royalties received from Germany to a resident ('X Ltd') of a non-treaty state under a sub-licensing agreement. As all the licensing agreements had to be submitted to X Ltd for prior approval, the German court ruled that X BV was not the beneficial owner of the royalties.

⁵⁰ *Conseil d'Etat*, 13 Oct. 1999, 191191, 8 and 9. See also B. Gilbert and Y. Oaumrane, *Beneficial Ownership – A French Perspective*, European Taxation 2008, No. 1, pp. 2–9.

⁵¹ See for a detailed discussion of the Diebold-case D. Gutmann, 'Beneficial Ownership without Specific Beneficial Ownership Provision', in Duff et al. *supra*, Ch. 10. Gutmann points to the fact that due to an advice of the French Supreme Administrative Court in 2009 the practical impact of the decision in the Diebold-case is rather insignificant.

⁵² *Indofood International Finance Limited v. JP Morgan Chase Bank, N.A., London Branch*, [2006] EWCA Civ 158, [2006] STC 1195. For a discussion, see R.F. and J.D.B.O., *Treaty shopping and beneficial ownership: Indofood International Finance Limited v. JP Morgan Chase Bank, N.A., London Branch*, British Tax Review 2006, pp. 422–429 and P. Baker, *Beneficial ownership: After Indofood*, GIRC Review, Vol. VI, No. 1, 2007, pp. 15–28 and P. Baker, 'United Kingdom: Indofood International Finance Ltd v JP Morgan Chase Bank NA', in Duff et al. *supra*, Ch. 2.

⁵³ *Indofood, supra*, [40].

⁵⁴ *Indofood, supra*, [43].

⁵⁵ *Indofood, supra*, [44].

⁵⁶ PUT-23288/PP/M.11/13/2010. As the Dutch company was required de facto to pass on all interest received and performed no activities other than issuing bonds and on-lending the funds, the court ruled that the company could not be regarded as the beneficial owner under the treaty.

⁵⁷ PUT-13602/PP/M.1/13/2008. In this case the Indonesian tax authorities claimed that a company registered in Mauritius could not be regarded as the beneficial owner of the dividends it received because of the existence of an interim (passive) holding company. The court refused, however, to uphold the claim because of the tax authorities' failure to substantiate it.

Spain

In 2006 the Spanish *Audiencia Nacional* applied the term 'beneficial owner' as a broad anti-abuse provision.⁵⁸ The case involved a Hungarian company passing on 98%–99.5% of the royalties received from the football club Real Madrid to a Dutch private limited company under a licensing agreement. There was also a clear link between the amounts received and paid in that the amount owed by the Hungarian company was transferred to the Netherlands on the same day or the day after the royalties were received from Spain. The court subjected the term 'beneficial owner' to an arm's length test. In other words, was there a commercial reason for interposing the Hungarian company? The court referred to documents such as the Conduit Report and the 2003 OECD Commentary in concluding that the payments in this case were not made to a beneficial owner.⁵⁹

The Spanish *Tribunal Económico Administrativo Central* ruled in an entity conduit case that an English company holding shares in a Spanish company was not the beneficial owner of dividends received from Spain. In the court's view, the English company, which had no activities other than holding the Spanish shares, had to be regarded as an intermediary, a trustee or a person receiving income for another party's account (in other words, for the shareholder resident in the United Arab Emirates).⁶⁰

France

As in *Diebold Courtage*,⁶¹ the French *Conseil d'Etat* applied the beneficial owner concept to its interpretation of the 1968 France-UK tax treaty in the *Bank of Scotland* case.⁶² In this case, a US parent of a French company had entered into a usufruct agreement with the Bank of Scotland. This three-year agreement entitled the bank to the dividend coupons attached to the shares in the French company. The latter distributed a dividend on 30 September 1993, and the bank claimed it was eligible for the relevant benefits under the tax treaty between the UK and France. The *Conseil d'Etat* ruled, however, that the usufruct agreement should be classified as a loan agreement under France's national anti-abuse rules. The Bank of Scotland had been

indemnified against any risk to which a shareholder would normally be exposed and this meant, according to the *Conseil d'Etat*, that it could not be regarded as the beneficial owner of the dividends. The fact that the recharacterization of the usufruct agreement was based on a rule in national law led Gibert and Ouamane to conclude that the term 'beneficial owner' did not allow scope for such recharacterization.⁶³ Gutmann too disagrees with the approach of the *Conseil d'Etat*. In his view, the court 'distorted the meaning of the concept because its goal was to apply the French general anti-avoidance theory without formally departing from the treaty rule'.⁶⁴

Canada

The well-known *Prévost Car Inc* case⁶⁵ relates to an entity conduit. *Prévost Holding BV* was owned by residents of the UK and Sweden and received dividends from its Canadian subsidiary. The sole activity of *Prévost Holding BV* was to hold the Canadian shares. The Canadian judge stated the following in respect of the term 'beneficial owner':

In my view the beneficial owner of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividends he or she received. (...) When corporate entities are concerned, one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it, for example, a stockbroker who is the registered owner of the shares it holds for clients.⁶⁶

The Federal Court of Appeal agreed and concluded, based on the facts of the case, that *Prévost Holding BV* was the beneficial owner of the dividends received. Interestingly, the court in first instance derived the above description from Canadian common law. The Federal Court of Appeal subsequently ruled this description of 'beneficial owner' to be in accordance with the 2003 Commentary on the

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⁵⁸ Case 1110/2003 (*Real Madrid FC*). See Jiménez [*supra* note 9] for an overview of comparable cases and A.M. Jiménez, 'Beneficial Ownership as a Broad Anti-Avoidance Provision: Decisions by Spanish Courts and the OECD's Discussion Draft', in Duff et al. *supra*, Ch. 8.

⁵⁹ Jiménez [*supra*, p. 40] points out that the Spanish court in this case did not examine the question of the legal ownership of the royalties paid and the extent to which the Hungarian company could control the royalties.

⁶⁰ RG 1481/2007.

⁶¹ See note 52.

⁶² *Conseil d'Etat*, 29 Dec. 2006, Case 283314. See also Gilbert and Ouamrane, *supra*, pp. 2–9 and Gutmann, *supra*, Ch. 11.

⁶³ Gilbert and Ouamrane, *supra*, p. 9.

⁶⁴ Gutmann, *supra*, para. 11.5.

⁶⁵ *Canada v. Prévost* (2009 FCA 57), 26 Feb. 2009 (<http://decisions.fca-cf.gc.ca/en/2009/2009fca57/2009fca57.html>). The decision in first instance: *Prévost Car v. The Queen* (2008 TCC 231), 22 Apr. 2008 (<http://decision.tcc-cci.gc.ca/en/2008/2008tcc231/2008tcc231.html>).

⁶⁶ *Prévost Car v. The Queen*, *supra*, para. [100].

OECD MC and the Conduit Report.⁶⁷ It is unclear from the judgment, however, whether the Federal Court also wished to apply the factual test referred to in the Commentary. This possibility cannot be excluded, given the unconditioned reference to the Commentary. However, the considerations mentioned above would seem to point to a very strict, legal test.

The judgment in *Prévost Car* played a decisive role in the Canadian *Velcro* case, which involved an income conduit.⁶⁸ The Dutch resident Velcro Holdings BV ('VH') received royalties from Velcro Canada (a Canadian resident). VH passed all (or almost all) of these royalties to Velcro Industries BV (resident in the Netherlands Antilles). The Canadian court ruled that VH should be regarded as the beneficial owner if it had: (a) possession, and (b) the right to use, and also (c) bore the risk, and (d) had control of the royalties received. The court decided that these conditions were met in this case because the funds were not transferred to separate bank accounts, were mixed with income from other sources and were wholly and unrestrictedly available to VH. In my view, the court in this case failed to recognize the nature of the contractual relationship between VH and Velcro Industries BV ('VI'). VH was contractually obliged to pass an amount equal to the royalties received (less a commercial fee for services provided) to Velcro Industries BV (a resident of the Netherlands Antilles) within thirty days of receipt. In other words, in my view there was a legal relationship between the royalties received by VH and its payment liabilities.⁶⁹

Czech Republic

In a case involving an entity conduit, the highest administrative court in the Czech Republic ruled that a company receiving dividends (in this case, a Dutch BV) did not qualify as a beneficial owner if it did not exercise its shareholder rights and its sole purpose was to act as a conduit so as to enable a reduced rate of tax to be obtained under a treaty.⁷⁰ This judgment, however, did not clarify

matters in any way as the court failed to specify the conditions in which beneficial ownership would be considered to apply.

Denmark

The Danish tax authorities have been very active in recent years in bringing cases involving alleged abuses of tax treaties to court, both in situations involving entity conduits and in situations involving income conduits. This contribution examines firstly the views of the tax court (*Landsskatteretten*) in the *HHU* income conduit case⁷¹ and secondly the judgment reached by the Court of East Denmark (*Østre Landsret*) in the first *ISS*⁷² entity conduit case.⁷³

The *HHU* case concerned the question of whether a Swedish company ('AB 1'), established for the purposes of acquiring a Danish company, was the beneficial owner, within the meaning of the tax treaty between Denmark and Sweden, of the interest it received. The shareholder of AB 1 was also a Swedish company ('AB 2'), the shares of which were owned by a Jersey-resident company. AB 2 borrowed the funds to acquire the Danish company from its shareholder and contributed the assets funded by this loan as capital to AB 1. AB 1 lent the same amount to the Danish company holding the acquired company. The interest that AB 1 received (taxable in Sweden) was transferred to AB 2 in the form of a (deductible) 'group contribution'⁷⁴ (*koncernbidrag*). The latter company subsequently passed the same amount of interest to its shareholder. The net result was no taxable profit at either AB 1 or AB 2. The court referred to paragraphs 8 and 8.1 of the 2003 Commentary on Article 11 of the OECD MC in ruling that AB 1 was not the beneficial owner of the interest paid. The court considered it important in this respect that the Swedish companies did not actually have any rights of control over the interest received, given that they had no other sources of income with which to fulfil their payment obligations. According to the court, the Danish company de facto paid interest to the ultimate

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⁶⁷ 'Most importantly, perhaps, the formulation accords with what is stated in the OECD Commentaries and in the Conduit Companies Report.' *Canada v. Prévost*, *supra*, para. [13].

⁶⁸ See also Brian J. Arnold, *Tax Treaty Case Law News – A Trio of Recent Cases on Beneficial Ownership*, Bulletin for International Taxation, 2012, No. 6, and in 'The Concept of Beneficial Ownership under Canadian Tax Treaties' in Duff, et al. *supra*, para. 3.3.3. and W.R. Munting, *Beneficial Ownership: handle with care*, WFR 2012/1064.

⁶⁹ Arnold ['The Concept of Beneficial Ownership under Canadian Tax Treaties' in Duff, et al. *supra*, para. 3.3.3.] considers the outcome 'clearly wrong'.

⁷⁰ The Czech court applied the 'beneficial owner' concept in this case, even though the tax treaty between the Czech Republic and the Netherlands dates back to 1963 and does not include a criterion of beneficial ownership. The tax authorities applied the substance-over-form approach from national law. According to the court, the benefits of the treaty cannot be enjoyed. P. Fekar, *Czech Supreme Administrative Court on Beneficial Ownership: Czech Supreme Administrative Court, Decision of 10 Jun. 2011, Ref. No. 2, Afs 86/2010-141*, European Taxation 2011, No. 9/10, p. 418.

⁷¹ SKM 2011.57.

⁷² SKM 2012.121.

⁷³ The other cases are SKM 2010.268, SKM 2010.729, SKM 2011.485, SKM 2012.409 and SKM 2012.729. For a discussion of these cases, see T. Booker, *Recent Developments Regarding Beneficial Ownership in Denmark*, European Taxation 2012, pp. 67–76, J. Bundgaard, *Danish Case Law Developments on Beneficial Ownership*, Tax Notes International, October 2012, pp. 63–74, H. Severin Hansen, L. Esbjerg Christensen and A. Endicott Pedersen, *Danish 'Beneficial Owner' Cases – A Status Report*, Bulletin for International Taxation 2013, No. 4/5, and J. Bundgaard, 'The Notion of Beneficial Ownership in Danish Case Law: The Creation of a New Legal Order with Uncertainty as a Companion', in Duff et al. *supra*, Ch. 6.

⁷⁴ Use was made of the Swedish rule allowing profits and losses of companies within the same group to be offset via a group contribution.

shareholder in Jersey, while another important consideration for the court was that the sole purpose of establishing the Swedish companies was to avoid Danish withholding tax and that no net tax was paid in Sweden.⁷⁵

In the *ISS* case, a Danish holding company (Holdco S A/S) paid a dividend to its Luxembourg parent company (LuxCo Sarl). This dividend was then transferred to the Danish holding company as a loan. LuxCo Sarl had no activities other than holding the shares in Holdco S A/S, while it also had no employees and was managed by the management companies of its shareholders, Goldman Sachs and a private equity fund. The Danish court ruled, with reference to *Indofood*, that the case involved an international fiscal concept. The court also inferred from the Conduit Report and the 2003 OECD Commentary (which the court saw as clarification of the older Commentary) that the term 'beneficial owner' could not be used to combat every possible abuse (alleged or otherwise) of tax treaties. If the relevant company law allows a holding company board to exercise control of dividends received, such a company cannot normally be said not to be the beneficial owner. In principle this also applies to the intermediate holding company. According to the court, it had to be decided whether the shareholders of such an intermediate holding company exercised a degree of power and control extending beyond what was normal in international groups. It is unclear, however, whether these considerations were relevant to the judgment ultimately reached. The deciding factor for the court was ultimately the fact that LuxCo Sarl did not pass the dividend received to a resident of a non-treaty state and was also not obliged to pass on the dividend at a later date. For that reason, LuxCo Sarl was ruled to be the beneficial owner. The court seems to have considered the only issue of importance to be whether the income was passed to a resident of a non-treaty state. The capacity in which any onward payment was made seems to have been irrelevant.

Switzerland

The Swiss Federal Administrative Court (*Bundesverwaltungsgericht*) applied a substance-over-form approach when assessing whether a recipient of income was also the

beneficial owner of that income.⁷⁶ In the case in question, a Danish bank holding Swiss securities was involved in a Total Return Equity Swap.⁷⁷ The Swiss securities were bought in order to hedge the obligations arising from the swap transaction. The bank, however, was not obliged to arrange this hedge. The question was whether the Danish bank could be seen as the beneficial owner of the dividends distributed on the Swiss shares. According to the Swiss court, no account had to be taken of any subjective element (i.e., the object and purpose of the transactions were not relevant). Instead, the important question was who was authorized to take decisions on the income distributed? These powers had to be assessed on the basis of the concrete facts and circumstances of the case. According to the *Bundesverwaltungsgericht*, there could be no beneficial ownership of the income in the event of any obligation *de jure* or *de facto* to pass on or distribute the income to a third party. If such an obligation existed, the recipient could be regarded as having no decision-making powers over that income. The court believed it important to establish the degree to which the obligation to pass on funds was dependent on receipt of the income⁷⁸ and concluded from the facts of this case that the Danish bank should be regarded as the beneficial owner. The court also stated incidentally that the concept of beneficial ownership was part of the attribution provisions and not an anti-abuse concept.

5.3 Conclusions Based on the Examination of Case Law

A number of elements of importance in assessing the changes proposed by the OECD can be derived from the case law examined. As far as entity conduits are concerned, the main issue – in the absence of any obligation to pass on income – is whether the degree of substance at the conduit level, the control relationships within the group and any abuse character in the use of the conduit are relevant. The relevant issue in the case of income conduits concerns the conditions attaching to the obligation to pass on income. In most of the cases examined, the company receiving the income is not regarded as the beneficial

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⁷⁵ There are some interesting similarities between the Danish court's ruling and the decision by the highest Swedish administrative court (*Högsta Förvaltningsdomstolen*) of 21 May 2012 (case HFD 2012, note 24). This latter case concerned the scope of the term 'beneficial owner' within the context of an anti-abuse provision in national law and involved a Swedish company that paid interest to a Dutch group company ('BV I'). BV I formed a fiscal unity with BV II. The interest received by BV I was passed to BV II as a dividend. BV II used this income to pay interest to its US parent company. The Swedish court ruled that BV I could not be regarded as the beneficial owner of the interest, specifically because of the structure's anti-abuse character. According to Kleist, this ruling is equally important for interpreting the term 'beneficial owner' in Sweden's tax treaties. D. Kleist, *First Swedish Case on Beneficial Owner*, Intertax 2013, No. 3, pp. 159–163.

⁷⁶ 'Der Begriff dient dazu, die Intensität der Beziehung zwischen einem Steuersubjekt und einem Steuerobjekt aus einer wirtschaftlichen Betrachtungsweise zu beurteilen. Das Konzept des beneficial owner bezieht sich anhand einer sog. 'substance-over-form'-Betrachtung auf die wirtschaftliche Realität und stellt nicht auf die (zivilrechtliche) Form ab.' *Bundesverwaltungsgericht*, 7 Mar. 2012, A-6537/2010. For a discussion of this case, see B. Arnold, *Tax Treaty Case Law News – A Trio of Recent Cases on Beneficial Ownership*, Bulletin for International Taxation 2012, No. 6 and IFA, Seminar J: *Recent developments in international tax*, 4 Oct. 2012, published via www.ibfd.org. The *Bundesverwaltungsgericht* reached the same conclusion in a comparable case. See *Bundesverwaltungsgericht*, 23 Jul. 2012, No. A-1246/2011 and No. A-6537/2010.

⁷⁷ A financial instrument requiring one party to transfer all the proceeds from shares to another party in return for a fixed fee paid in instalments.

⁷⁸ '3.4.2. (...) Die Entscheidungsbefugnis ist umso schwächer, je stärker eine gegenseitige oder wechselseitige Abhängigkeit bzw. Interdependenz zwischen den Einkünften und der Pflicht zu deren Weiterleitung besteht.'

owner if all or almost all the income is de facto passed on to another party. Most of the national courts did not consider the question of whether the receiving company had full legal ownership of the income to be relevant. Whether the nature of the obligation requiring the income received to be passed on is relevant is unclear.

As a general rule, the question whether and, if so, in which situations treaty states can apply the condition of beneficial ownership in order to combat treaty shopping should be made clear in the Commentary.⁷⁹

6 THE 2012 OECD DISCUSSION DRAFT

This section examines the changes proposed in the OECD's discussion draft of 19 October 2012.⁸⁰ This draft contains substantial changes compared with the discussion draft of 29 April 2011.⁸¹ The proposals contained in the discussion draft of 19 October 2012 are included here in full, insofar as relevant for this contribution:⁸²

12.1 Since the term beneficial owner was added to address potential difficulties arising from the use of the words 'paid to . . . a resident' in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries).

In my view, the OECD makes it clear in paragraph 12.1 that the beneficial ownership concept is an autonomous tax treaty concept. Indeed the majority of commentators on the first discussion draft supported this approach. However, Munting and Huisman commented that – even after amendment of the first draft – the OECD had still not entirely ruled out the possibility of the concept being interpreted in accordance with national law.⁸³ They base their conclusion on the OECD's notes on the amendments to the first draft. In my view, however, the wording of paragraph 12.1 leaves no room for doubt in this respect.⁸⁴

Paragraphs 12.2 and 12.3 accord with the current paragraph 12.1 (see section 4.5 above for the wording), while the examples given in 12.3 are further clarified in 12.4:

12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the 'beneficial owner' because that recipient's right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation must be related to the payment received; it would therefore not include contractual or legal obligations unrelated to the payment received even if those obligations could effectively result in the recipient using the payment received to satisfy those obligations. Examples of such unrelated obligations are those unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1. Where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the 'beneficial owner' of that dividend. It should also be noted that Article 10 refers to the beneficial owner of a dividend as opposed to the owner of the shares, which may be different in some cases.

The most important changes are found in paragraph 12.4. In this new paragraph, the OECD emphasizes the limited scope of the beneficial ownership concept as an anti-abuse

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⁷⁹ For example for situations such as the Danish *HHU* case, in which the application of national law (in this case, that of Sweden) de facto creates an income conduit.

⁸⁰ For the sake of completeness, it should be noted that, from 2010, the term 'beneficial owner' is also used in para. 6.14 of the Commentary on Art. 1 of the OECD MC (in the context of 'Collective Investment Vehicles'). This addition does not shed any new light, however, on the contents of the provision.

⁸¹ For a discussion of the changes, see Munting and Huisman, *supra*. One of the important changes relates to the passage contained in para. 12.4 of the original proposal and in which it is stated that the recipient of the income cannot be considered the beneficial owner if this recipient 'does not have the full right to use and enjoy the dividend that it receives'. Almost all the reactions to the proposal for this passage were critical. See, for example, the reaction of Avery Jones, Vann and Wheeler, who conclude that this wording incorrectly looks for full ownership of the income, whereas beneficial ownership of income is primarily an issue in situations in which a person has only limited rights over the income, but nevertheless qualifies as the beneficial owner. J.F. Avery Jones, R. Vann and J. Wheeler, *Response on the OECD Discussion Draft 'Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention'*, p. 1, <<http://www.oecd.org/tax/treaties/48420432.pdf>>.

⁸² The position of a trust as a beneficial owner is not discussed here as the case law examined does not consider this issue. For examples of commentary on this subject, see Avery Jones, Vann and Wheeler, *supra*, p. 1, and Danon, *supra*, para. 4.

⁸³ Munting and Huisman, *supra*, para. 2.1. As this contribution focuses primarily on the changes in the Commentary, no consideration is given to whether Art. 3(2) of the OECD MC means that countries that define the concept of beneficial ownership in their national law have to use that national law definition when applying treaties based on the OECD MC or whether the context requires there to be a tax treaty meaning autonomous of that national law concept. I agree with Pötgens [*supra*, pp. 167–176] that the concept is an autonomous tax treaty concept.

⁸⁴ Van Weeghel seems to reach the same conclusion. S. van Weeghel, 'Enkele observaties over de uiteindelijk gerechtigde', in Th. Groeneveld and L.J.A. Pieterse (eds.), *Met oog voor detail, liber amicorum mr. J.W. van den Berge*, Den Haag: SDU 2013, p. 323.

measure. The OECD favours an approach to the concept, whereby a person is a beneficial owner of dividends received unless the right to use and enjoy the dividends is constrained by a contractual or legal obligation to pass the funds received to another party. In the absence of any such obligation, the relevant party will have beneficial ownership, irrespective of any de facto constraints on its right to use and enjoy the funds. These constraints could include, for example, a situation in which group policy required a company to distribute dividends received. As no such contractual or legal obligation exists in the case of entity conduits, this amendment confirms the conclusion that the OECD will generally regard entity conduits as the beneficial owner.⁸⁵

If there is a contractual or legal obligation to pass the funds received to another party, the question is how to assess whether the right to use and enjoy the income is constrained by that obligation. Although the wording used by the OECD may be considered not entirely conclusive,⁸⁶ in my view such constraint 'will normally normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances (...)'. This approach resembles the one in paragraph 44 of the *Indofood* judgment: 'But the meaning to be given to the phrase "beneficial owner" is plainly not to be limited by so technical and legal an approach. Regard is to be had to the substance of the matter.'⁸⁷ It follows that the beneficial owner should be able to have 'unconstrained' enjoyment of the income both de jure and de facto.⁸⁸ It is unclear to me, however, how the term 'unconstrained' relates to the 'very narrow powers' referred to in the current paragraph 12.1. Any relatively minor restriction of the right to use and enjoy the income will lead to the conclusion that this right is not unconstrained, while for the test in paragraph 12.1 one such limitation does not automatically mean there to be 'very narrow powers'.

According to the new version of the discussion draft, the legal or contractual obligation constraining the use and enjoyment of the dividend must be related to the payment received. Merely using the income to fulfil a specific obligation does not mean there is a related

obligation in the sense referred to here. The relationship required between the obligation and the income received prompts various questions. The first of these relates to the nature of the obligation: if interest is received, does the payment have to be passed to another party in the form of interest? This would seem to me to be the case, but it is not evident from the notes. Another aspect that is unclear is the perspective from which the existence of such an obligation has to be assessed. Should the source state decide on the basis of its own national law whether the receiving company meets this requirement? This would seem likely, given that it is the source state that has to apply the reduced tax rate. The same applies in respect of a residence state that may have to grant a foreign tax credit in order to avoid double taxation.⁸⁹ It would be advisable to clarify this aspect.⁹⁰

The next question is whether the extent of the obligation matters. If an asset on which interest is received is funded by a combination of own resources and borrowed capital, is there still a relationship as referred to in paragraph 12.3 in respect, for example, of the element passed on to another party? And what if the asset is funded wholly by borrowed capital, but not all the interest received is passed to another party because a small amount is retained as remuneration for the company borrowing and on-lending the funds? The addition of paragraph 12.4 does not entirely clarify the position of income conduits, therefore.⁹¹

Paragraph 12.5 examines the relationship with anti-abuse provisions and explicitly states that the beneficial ownership concept should not be seen as restricting the application of general rules and specific anti-abuse provisions in any way. The beneficial ownership concept therefore has a limited scope.

7 CONCLUSIONS

Do the proposed changes remove the ambiguity in the meaning of beneficial ownership that leads national courts

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⁸⁵ Based on the wording of para. 12.4 in the draft discussion of 29 Apr. 2011, Avery Jones, Vann and Wheeler [*supra*, p. 4] concluded that the possibility of an intermediate holding company not being regarded as the beneficial owner was not excluded. They suggested that the only situation in which a recipient should not be regarded as the beneficial owner was where there was a legal obligation to pass the income to another party.

⁸⁶ Gutmann points to the question whether para. 12.4 says that 'the obligation may stem from facts, as "a factual obligation" is close to nonsense.' D. Gutmann, The 2011 Discussion Draft on Beneficial Ownership: What is Next for the OECD, in Duff et al. *supra*, Ch. 21.

⁸⁷ Based on para. 44 of the judgment of the Court of Appeal, Baker concludes: 'It is, therefore, relevant to examine all aspects of a transaction and not just its legal form when enquiring into beneficial ownership.' Baker, *United Kingdom: Indofood International Finance Ltd v. JP Morgan Chase Bank NV*, in Duff et al. *supra*, para. 2.5. The wording used by the OECD could be inspired by the guidance provided by the UK HMRC after the *Indofood*-decision. In document INTM504030 is stated: 'This obligation [to pass the received income on to another person, addition JG] might be found in legal documents, but the Court of Appeal was also clear that such an obligation might also be found by looking at the commercial and practical substance of an arrangement.' Quoted from P. Baker, 'United Kingdom: Indofood International Finance Ltd. v. JP Morgan Chase Bank NA', in Duff et al. *supra*, para. 2.5.

⁸⁸ According to Gutmann [*supra*, Ch. 21] the expression 'in substance' should be deleted from the para. 12.4 as it is 'extremely unclear'.

⁸⁹ See, for example, Art. 16 of the Dutch Double Taxation (Avoidance) Decree [*Besluit voorkoming dubbele belasting*] 2001.

⁹⁰ See also the recommendations of Avery Jones, Vann and Wheeler, *supra*, p. 6. Please refer to Reimer who addresses two basic sets of elements that should be considered dealing with the question of beneficial ownership: payments parameters and asset parameters. E. Reimer, 'How to Conceptualize Beneficial Ownership', in Duff et al. *supra*, para. 18.5.

⁹¹ See also Van Weeghel [*supra*, p. 324].

to interpret the concept in differing ways, and do these changes mean that courts will in future be able to assume a uniform understanding of the concept? On the basis of the judgments examined, it can be stated that these questions can only partially be answered in the affirmative. First, it is important to note that all the judgments examined assume the concept of beneficial ownership to have a meaning that is autonomous of national law except for the Canadian cases. In that respect, the addition in paragraph 12.1 would seem of limited value.

Progress has been achieved, however, with regard to the application of the beneficial ownership concept to entity conduits. If there is no legal or contractual obligation to pass dividends received to another party, an entity conduit cannot be denied classification as a beneficial owner. Treaty states wishing to exclude entity conduits from reduced rates of withholding taxes will therefore have to include supplementary provisions to this effect in their treaties.⁹² Indeed the possibility of this is referred to in the new paragraph 12.5. A number of the judgments examined make reference to actual control relationships or the use (or otherwise) of shareholder rights. Given the changes proposed, however, these facts are not relevant for determining beneficial ownership.

Although the ambiguity in respect of income conduits persists, some progress has, I believe, been achieved in respect of these situations. The explicit requirement for the legal or contractual obligation constituting a restriction on the use and enjoyment of the income to be related to the payment received will ensure greater clarity. The approach proposed in paragraph 12.4 is consistent with the line followed in the vast majority of the judgments. Almost all the cases involving an income conduit include an obligation to pass on a payment relating – either *de jure* or *de facto* – to the income received. In this sense, almost all the judicial authorities adopt a restrictive, rather juridical approach to the concept, despite the references in many of these cases to a wide anti-abuse provision. The critical issue is who is entitled – either *de jure* or *de facto* – to use and enjoy the income.

There are, however, differences in the factual grounds on which the judicial authorities base their views on whether funds received are passed on. It can be concluded from the proposed changes that the following arguments

used by national courts are not relevant for determining whether a party is a beneficial owner:

- the underlying reason for interposing the income conduits. The beneficial ownership concept does not imply the application of a business motives test;
- the nature and extent of the income conduit's activities;
- whether the income conduit is subject to tax.

As mentioned above, paragraph 12.4 in the proposals does not clarify whether a party can be considered the beneficial owner if it is not required – *de jure* or *de facto* – to pass on all the income. In the income conduit judgments examined, all or a very substantial part of the income was passed on. However, it is not possible to arrive at an exact turning point on the basis of the case law to date.⁹³

The question to be answered, with the above considerations in mind, is whether additional amendments to the Commentary or the OECD MC may help achieve greater clarity. There are two aspects that I would see as beneficial, in addition to the need to provide more explanatory information on the questions raised in respect of the wording of the proposals. First, including a definition of beneficial owner in Articles 10, 11, and 12 of the OECD MC would end the discussion of whether the concept has an international fiscal meaning autonomous of national law.⁹⁴ Although the case law examined leads us to conclude that most national courts interpret the beneficial ownership concept as having an autonomous tax treaty meaning, the reactions to the discussion draft showed that this approach admittedly enjoys broadly based support, but is not yet unanimously accepted. In my view, the proposed changes provide a sufficient basis for compiling a definition. A beneficial owner can be defined as a party receiving income not for the risk and account of another party and that is not obliged – *de jure* or *de facto* – to pass on all or almost all of this income under a related legal or contractual obligation.⁹⁵

Even if this definition is adopted, a certain degree of uncertainty will, however, remain as to whether the recipient of the income is the beneficial owner, particularly in situations in which a large part of, but not all the income received is passed on. For that reason, I would suggest limiting this uncertainty by including wording in the Commentary to the effect that if the percentage that is

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⁹² See also the comments in *Vakstudie Nieuws* 2012/62.4 and Munting and Huisman, *supra*, where an expectation that countries will introduce specific anti-abuse provisions is voiced.

⁹³ This relates to the question of when the existence of 'narrow powers' in respect of the income turn into the 'very narrow powers' referred to in the current para. 12.1 of the Commentary.

⁹⁴ Based on several branch reports for the 2010 IFA Congress in Rome, Van Weeghel already concluded that 'the notion that the term needs no definition seems to be wrong.' S. van Weeghel, *Tax treaties and tax avoidance: application of anti-avoidance provisions*, Cahier de droit international, Vol. 95a, Den Haag: SDU 2010, p. 20.

⁹⁵ Van Weeghel proposes to include a definition that excludes agents and nominees as beneficial owners. He suggests that countries use other measures such as limitation on benefits rules to combat treaty shopping. S. van Weeghel, 'Enkele observaties over de uiteindelijk gerechtigde', in Th. Groeneveld and L.J.A. Pieterse (eds.), *Met oog voor detail, liber amicorum mr. J.W. van den Berge*, Den Haag: SDU 2013, p. 326.

not passed on is consistent with an arm's length fee for the services provided in the examples referred to in paragraph 12.4 ('agent, nominee, . . . fiduciary or administrator'), all or almost all the income will be considered to be passed on.⁹⁶

Obviously, the proposed de facto approach would even after this addition affect to a certain extent the certainty provided by the tax treaty. This is the main reason why a more limited and strict legal approach is promoted by various tax scholars, suggesting the introduction of general anti-avoidance rules, limitation of benefits rules or a main purpose test.⁹⁷ There are however in my view good arguments to take the suggested de facto approach. First, despite any possibly valid hesitations from a historical perspective the concept has already been recognized broadly as an anti-abuse concept. Taking a pragmatic approach there is no reason not to use this already existing concept especially under existing treaties without general or specific anti-avoidance rules. Second, as

also stated by Pistone, beneficial ownership clauses aim at assuring a correct application of double tax treaty: is the person claiming the treaty benefits really the person that should benefit from the treaty?⁹⁸ In that light the intention of the parties involved is of little relevance when applying the beneficial owner test.

The above leads me to conclude that the OECD's proposals create greater clarity on the concept of the beneficial owner. Entity conduits will generally qualify as the beneficial owner. Treaty states that regard this as unwelcome will have to include supplementary provisions to this effect in their treaties.⁹⁹ Whether an income conduit will constitute a beneficial owner will depend on the facts and circumstances of the case. The OECD has included a number of relevant criteria in the draft Commentary in an effort to answer this question. However, certain aspects of these criteria still need to be elaborated in more detail.

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⁹⁶ See also Verdoner, Offermans and Huibregtse, who propose seeking alignment with the transfer pricing method. L. Verdoner, R. Offermans and S. Huibregtse, *A Cross-Country Perspective on Beneficial Ownership – Part 2*, European Taxation 2010, No. 10.

⁹⁷ For example Jimenez, *supra*, Ch. 8, Vann, *supra*, para. 19.6, Gutmann, *supra*, para. 11.5 and D.G. Duff, 'Responses to Treaty Shopping: A Comparative Evaluation', in M. Lang et al. *Tax Treaties from a Legal and Economic Perspective*, Amsterdam: IBFD, 2010, p. 94.

⁹⁸ Pistone, *supra*, para. 12.2.

⁹⁹ For example through one of the measures suggested in the paras 13–20 in the OECD Commentary on Art. 1 OECD_MC.